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SUBJECT: UK BANKS: LARGE EXPOSURE TO THE UAE, BUT STILL SMALL TO  
OVERALL TOTAL LOAN AMOUNTS

¶1. (U) SUMMARY: UK banks have greater exposure to the United Arab Emirates (UAE) than their global counterparts, but the potential impact of debt problems in Dubai on the UK banking sector is unlikely to be significant, say industry analysts. Analysts viewed the initial media frenzy following the announcement that Dubai World would delay forthcoming debt payments (including some papers speculating about the possibility of a "Financial Crisis 2"), as probably unwarranted. More than direct exposure, analysts are closely watching potential spillover effects of a Dubai World default within the UAE and among its neighbors - which could signal a broader problem. End Summary.

¶2. (U) British banks have total exposure to Dubai World of approximately \$5 billion, making them the organization's largest foreign creditors. Of British lenders, the Royal Bank of Scotland (RBS) is the most exposed, at up to \$2 billion, according to the Financial Times. RBS (majority government-owned) and Barclays may also be more vulnerable to spillover given their global write-downs and losses. UK bank loans to the UAE as a whole totaled \$49.5 billion in June, according to data from the Bank for International Settlements (BIS), compared to \$10.6 billion from the United States, \$11.3 billion from France and \$9 billion from Japan. London-based HSBC had the biggest exposure to the UAE at the end of 2008 (the latest available figures), with loans estimated at \$17 billion by the Emirates Banks Association. Standard Chartered ranked behind HSBC as the foreign bank with the most loans to the UAE, with \$7.8 billion. Barclays and the Royal Bank of Scotland (through ABN Amro) ranked next for loan exposure, with loans of \$3.6 billion and \$2.2 billion respectively. In comparison, Citigroup, ranked highest among U.S. banks, had loans of \$1.9 billion.

¶3. (SBU) While these exposures are large on an absolute basis, they are fairly small relative to the size of the groups and their total loan exposure. In a research note dated November 27, JP Morgan highlighted that the loans to the UAE as a percentage of the total loans made by each bank were as follows: HSBC - 1.8 percent; Standard Chartered - 4.4 percent; Barclays - 0.4 percent; and RBS - 0.4 percent. Consequently, JP Morgan analysts concluded that the direct loan exposure risk to UK banks should not be cause for concern. These sentiments were shared by Paul Chisnall, Executive Director for Financial Policy at the British Bankers' Association (BBA). Chisnall told us that direct exposures are not out of proportion for the size of the groups and that the initial media frenzy following the announcement that Dubai World would delay forthcoming debt payments (including some papers speculating about the possibility of a "Financial Crisis 2"), was probably not warranted. The rating agency Fitch appears to have agreed with the sentiment at JP Morgan and the BBA; Fitch on December 1 decided not to change its outlook for major British banks.

¶4. (SBU) But despite limited cause for concern regarding the banks' direct loan exposure to the UAE, Chisnall said he is concerned that Dubai's debt problems could signal a further wave of global recession. He said this indirect concern is far greater than problems posed by direct loan exposures and could have a far larger

impact on the UK banking sector. JP Morgan's UK equity analysts are worried about potential spillover effects within the UAE and among its neighbors - which could also result in significant problems for UK banks.

15. (SBU) Comment: An unknown is the significance of Dubai World's commercial landholdings in the UK. However, a fire sale of assets in the UK is unlikely, according to reports in The Wall Street Journal, which quote a Dubai World official saying much of the company's UK real estate is ring-fenced within offshore companies. The assets are protected from default by the parent company because the offshore companies have separate loans. Another unknown causing concern in the UK banking sector is the degree to which the UAE government will guarantee Dubai debts. JP Morgan analysts in the UK speculate that Dubai will continue to receive support from the UAE federal government or possibly the emirate of Abu Dhabi and would eventually be able to fulfill all its debt obligations.

SUSMAN